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**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001**

**EXPERIMENTAL CHANGES TO
IMPLEMENT CAPITAL ONE NSA**

DOCKET No. MC2002-2

**DIRECT TESTIMONY
OF
STUART ELLIOTT
ON BEHALF OF
CAPITAL ONE SERVICES, INC**

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September 19, 2002

1 **Volume Testimony**

2

3

4 **Autobiographical Sketch**

5

6 My name is Stuart W. Elliott. I am a Vice President at SLS Consulting, a

7 consulting firm located in Washington, DC. SLS specializes in economic,

8 operational and environmental analyses on behalf of the mailing community. I

9 have a B.A. in Economics from Columbia University and a Ph.D. in Economics

10 from the Massachusetts Institute of Technology. After my formal education, I

11 was a Research Fellow at Carnegie Mellon University, a Senior Analyst at

12 Project Performance Corporation (PPC), and a Senior Associate at

13 PricewaterhouseCoopers. While at PPC, I presented testimony in Docket No.

14 R2000-1 on behalf of the National Newspaper Association, the Recording

15 Industry Association of America, and Magazine Publishers of America.

16

17 **1. Purpose and Scope of Testimony**

18

19 The purpose of this testimony is twofold. First, the testimony briefly

20 reviews Capital One's projections of before-rates mail volumes and places those

21 projections in context for the Company. Second, the testimony derives after-

22 rates mail volume projections.

1 **2. Capital One's mail volume forecast represents a continuation of**
2 **historical levels of solicitation, with a reduced growth rate for customer**
3 **mail. For First-Class Mail solicitations, the continuation of historical**
4 **levels of mail volume contrasts with an eight-month period of unusually**
5 **high mail volume, from October 2001 to May 2002.**

6
7 Capital One has provided mail volume projections for FY 2003 in its
8 testimony for the types of mail covered by the terms of the Negotiated Service
9 Agreement (NSA). These projections are reproduced in Exhibit 1 for reference.
10 Exhibit 2 shows the Company's mail volumes for the same types of mail from
11 October 1999 to September 2002.

12 For Standard Mail solicitations, the data in Exhibit 2 show a high level of
13 month-to-month variation. For these solicitations, the graph in Exhibit 3 shows
14 that the average level of solicitations increased during FY 2000, but has been
15 roughly constant at 79 million pieces per month for the past two years.

16 For First-Class Mail solicitations, the data in Exhibit 2 also show a high
17 level of month-to-month variation. The graph of this mail volume in Exhibit 4
18 makes it clear that First-Class Mail solicitation volume has averaged about 63
19 million per month from October 1999 to July 2002, except for the period from
20 October 2001 to May 2002, when it averaged about 117 million.

21 For FY 2003, Capital One's projection of 768 million pieces of First-Class
22 Mail solicitation implies an average of 64 million pieces monthly. This represents
23 a continuation of the Company's historical rate of First-Class Mail solicitation that

1 has been in force for the past three years with the exception of the anomalous
2 eight-month period from October 2001 to May 2002.

3 For customer mail, the data in Exhibit 2 show a steady growth in mail
4 volumes since October 1999. This growth is shown graphically in Exhibit 5.
5 Over this period, the Company's customer mail grew at an annual rate of 32
6 percent.

7 The projected continuation of historical levels of solicitation with a higher
8 account base implies that annual account growth will be slower during FY 2003
9 than it has been in recent years. Slower account growth implies in turn slower
10 growth in customer mail volume. For FY 2003, Capital One projects that there
11 will be approximately 640 million pieces of customer mail. This represents an
12 annual increase of 9.8 percent over the estimated 583 million pieces of customer
13 mail that the Company will send in FY 2002.

14
15 **3. The increase in First-Class Mail solicitations during the eight-month**
16 **period from October 2001 to May 2002 was due to the unique,**
17 **anomalous post-9/11 environment. This increase was reversed by June**
18 **2002.**

19
20 The historical volume data show a large increase in First-Class Mail
21 solicitations in October 2001, followed by an equally large decrease starting in
22 June 2002.

23 The eight-month increase in First-Class Mail solicitation pieces that took
24 place from October 2001 until May 2002 was a temporary deviation from the

1 Company's historical level of First-Class Mail solicitation. The Company's
2 testimony explains this temporary increase in First-Class Mail solicitation
3 mailings as a result of "the unique market and environmental conditions in the
4 post-9/11 period, including the anthrax attacks."

5
6 **4. Capital One's mail forecast for FY 2003 clearly follows the outlines of**
7 **the Company's corporate strategy.**
8

9 In July 2002, Capital One announced its strategy involving a reduced level
10 of asset and account growth relative to the growth of the last two years.

11 The reduced level of asset growth involves a target annual growth rate of
12 20-25 percent during the second half of 2002 and during 2003 (8-K, July 16,
13 2002, p. 5-6). The Company expects account growth to be lower than projected
14 asset growth: "Account growth is expected to be modest in the second half of
15 2002, and somewhat higher in 2003" (8-K, July 16, 2002, p.6). Since it is
16 reasonable to expect that the level of customer mail volume is closely related to
17 the number of accounts, the projected customer mail growth of 9.8 percent in FY
18 2003 indicates that the projection is consistent with the strategy's announced
19 slowdown in account growth.

20 Since the levels of solicitation and customer mail projected by Capital One
21 for FY 2003 follow the Company's announced strategy, those projections are a
22 reasonable estimate of the Company's mail volumes.

5. Capital One's price response can be estimated by using price elasticities measured by the Postal Service.

The Postal Service measures price elasticities of -0.071 for workshared First-Class letters and -0.388 for Standard Mail (R2001-1, USPST-7 at 51 and 99).

Exhibits 6 and 7 use the Postal Service price elasticities to project a range of mail volume responses to the NSA price discounts. The range is obtained by calculating the price response in two different ways. Exhibit 6 shows the results of the first method, which applies the Postal Service's price elasticity for workshared First-Class Mail letters to Capital One's forecasts of First-Class Mail. Exhibit 7 shows the results of the second method, which decomposes the Company's First-Class Mail into its solicitation and customer mail portions, applies the Postal Service's Standard Mail elasticity to the solicitation mail, and then estimates new customer mail volume from the increase in accounts that will result from these new solicitations. These two estimates imply a range of 15-53 million for the after-rates increase in First-Class Mail.

**Exhibit 1: Capital One's Projection of FY 2003 Before-Rates
First-Class Mail Volume**

Type	First-Class Mail Volume
Solicitations	768,000,000
Customer Mail	640,000,000
Total	1,408,000,000

Source: Capital One testimony.

Exhibit 2: Capital One Volume of Customer Mail and Solicitations: October 1999 to September 2002

Month	Customer Mail	First-Class Mail Solicitations	Standard Mail Solicitations
Oct-99	23,753,037	78,771,652	30,248,391
Nov-99	24,924,804	99,036,307	15,345,511
Dec-99	28,323,271	56,759,404	7,921,155
Jan-00	25,733,873	90,404,633	56,792,786
Feb-00	24,438,019	35,453,537	34,437,081
Mar-00	27,320,181	53,057,033	39,614,873
Apr-00	29,480,138	38,846,756	28,331,357
May-00	30,351,077	53,642,857	50,397,191
Jun-00	30,470,815	82,813,549	55,393,585
Jul-00	30,068,221	63,641,402	47,904,323
Aug-00	32,449,688	48,333,024	66,828,624
Sep-00	31,289,392	52,860,401	105,033,143
Oct-00	35,458,669	36,680,749	119,564,729
Nov-00	36,222,564	69,978,222	82,909,126
Dec-00	38,333,630	69,555,071	32,121,903
Jan-01	37,538,604	71,609,132	94,006,455
Feb-01	37,228,200	67,678,601	73,448,261
Mar-01	40,595,396	79,707,394	85,245,080
Apr-01	39,584,216	53,734,153	93,752,823
May-01	39,613,572	68,816,452	94,422,524
Jun-01	40,094,283	50,499,839	63,251,136
Jul-01	43,936,373	77,390,674	70,807,874
Aug-01	41,780,602	61,920,684	101,295,653
Sep-01	40,206,176	81,359,208	69,564,731
Oct-01	46,379,476	117,256,121	88,010,149
Nov-01	42,756,595	157,721,160	88,765,050
Dec-01	49,050,084	114,868,000	25,136,785
Jan-02	49,347,570	111,473,290	105,436,265
Feb-02	46,416,492	97,894,068	83,400,395
Mar-02	50,472,716	118,835,045	86,376,653
Apr-02	50,248,542	98,176,516	97,144,193
May-02	51,306,612	121,404,738	76,604,133
Jun-02	48,162,673	56,909,685	54,916,252
Jul-02	48,732,181	36,351,765	41,894,720
Aug-02	50,000,000	43,000,000	
Sep-02	50,000,000	64,000,000	

Note: August and September 2002 are estimates
Source: Capital One.

Exhibit 3: Standard Mail Solicitation Volume, October 1999 to July 2002

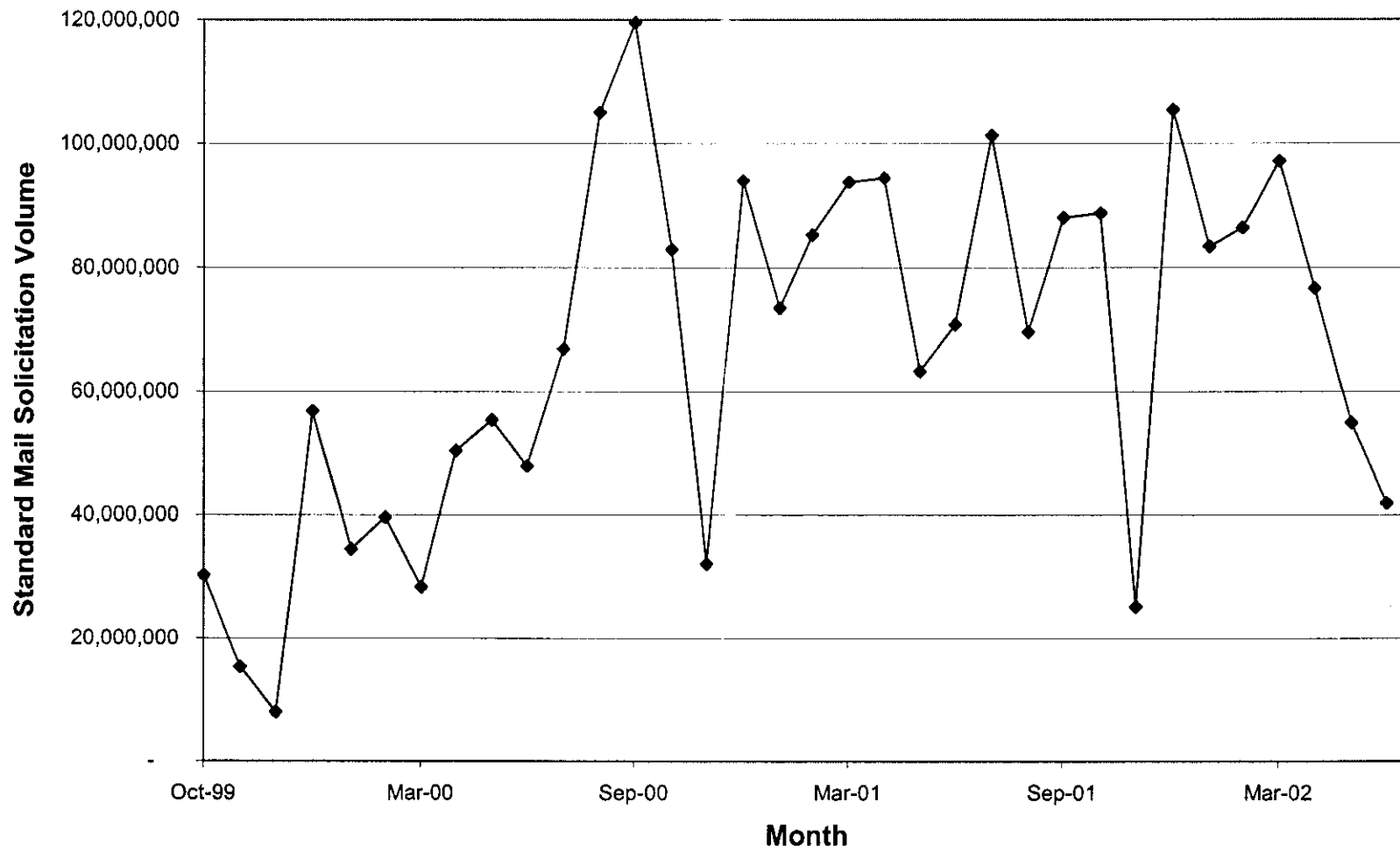


Exhibit 4: First-Class Mail Solicitation Volume, October 1999 to July 2002

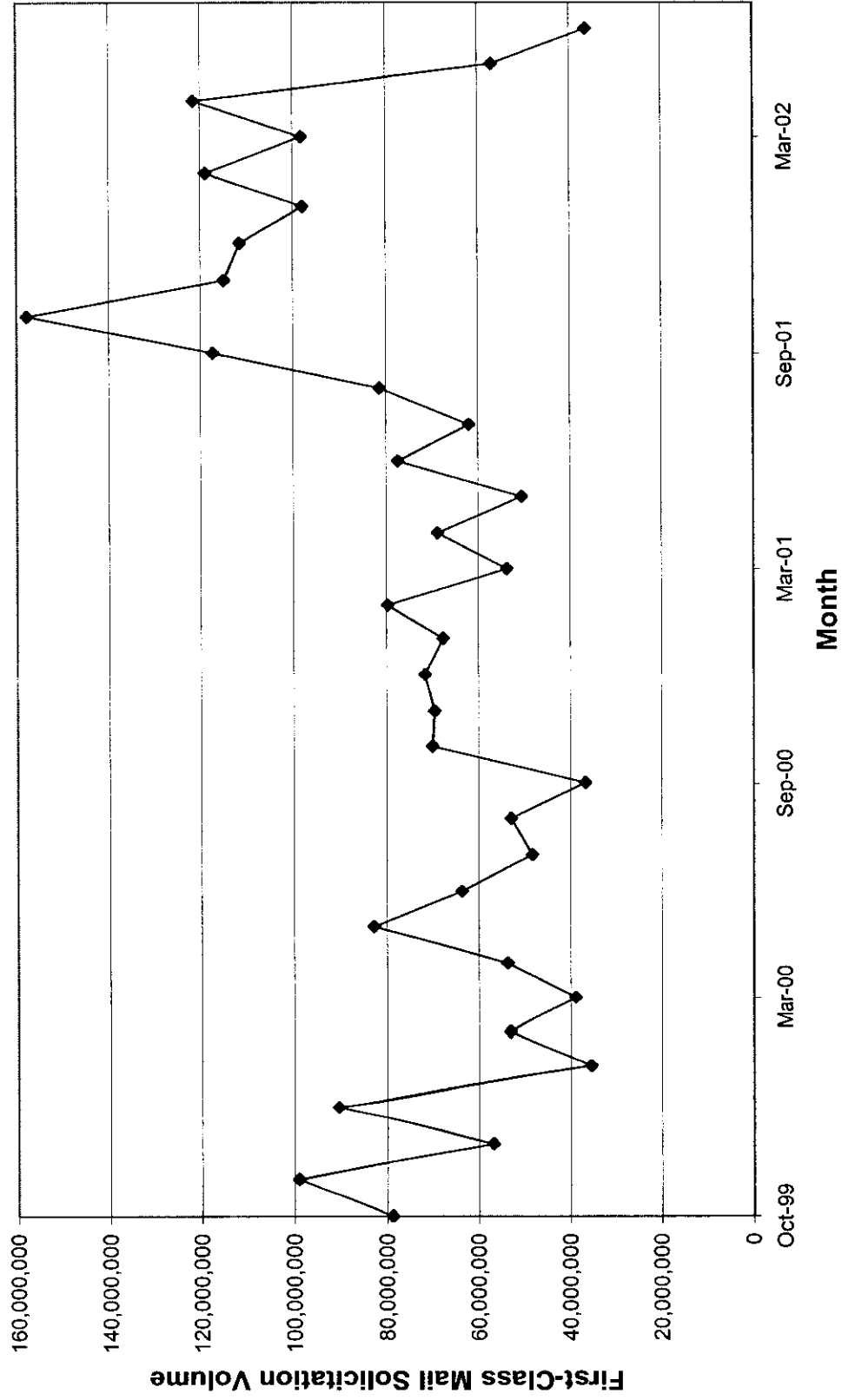


Exhibit 5: Customer Mail Volume, October 1999 to July 2002

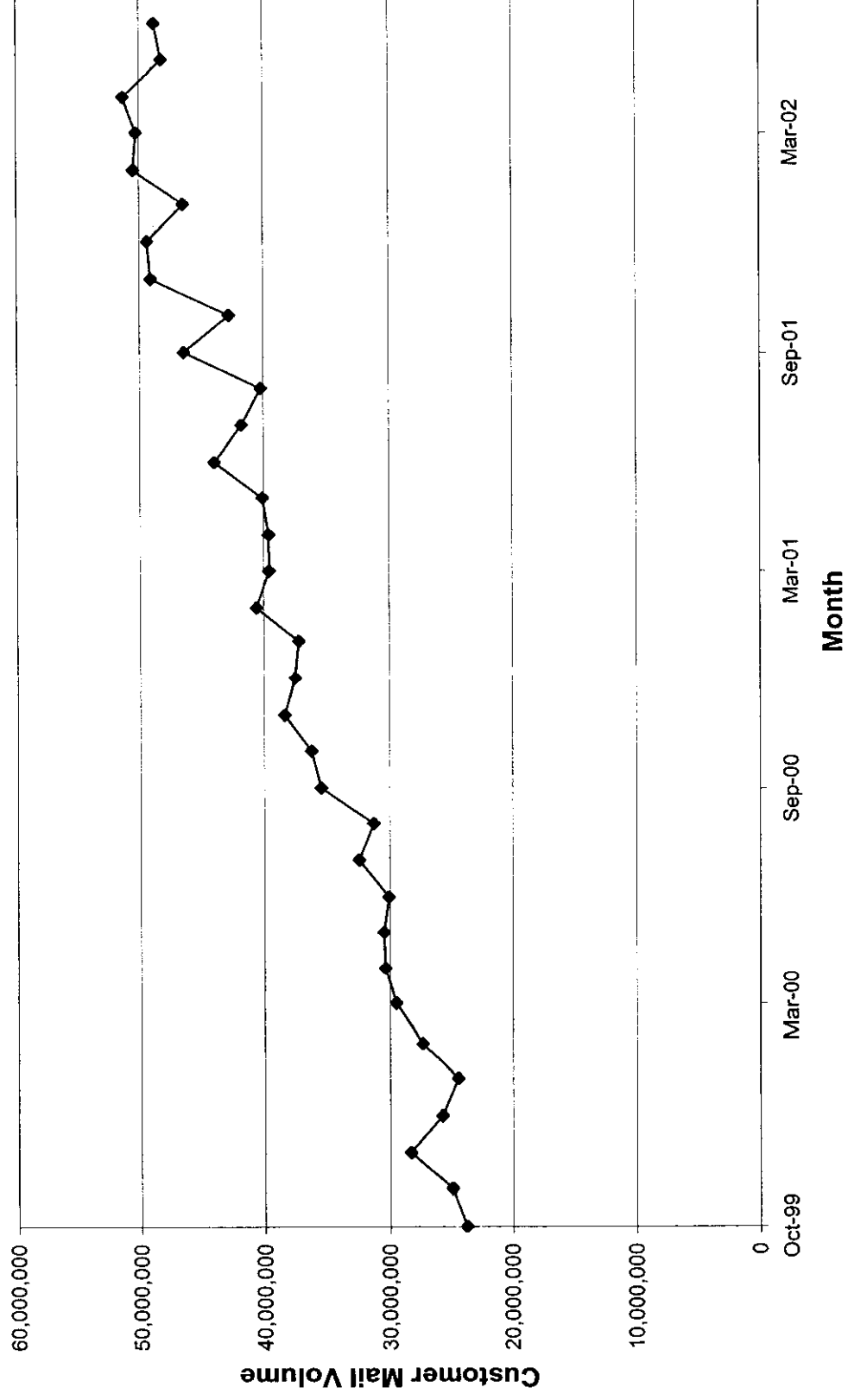


Exhibit 6: SLS Consulting Projection of Capital One After-Rates First-Class Mail Volume - Method 1

FY 2003 Capital One Before-Rates Projection

First-Class Mail Solicitation Volume	768,000,000	[1]
First-Class Mail Customer Mail Volume	640,000,000	[2]
Total First-Class Mail	1,408,000,000	[3]

SLS After-Rates Projection Using USPS Price Elasticities - Method 1

Price Elasticity - Workshared First-Class Letters	-0.071	[4]
Marginal Price Discount from NSA (Percent)	-15.5%	[5]
First-Class Mail Volume Increase (Percent)	1.1%	[6]
First-Class Mail Solicitation Volume Increase (Pieces)	8,432,165	[7]
First-Class Mail Customer Mail Volume Increase (Pieces)	7,026,804	[8]
Total First-Class Mail Volume Increase (Pieces)	15,458,969	[9]
After-Rates First-Class Mail Solicitation Volume (Pieces)	776,432,165	[10]
After-Rates First-Class Mail Customer Mail Volume (Pieces)	647,026,804	[11]
Total After-Rates First-Class Mail Volume (Pieces)	1,423,458,969	[12]

[1] Capital One testimony

[2] Capital One testimony

[3] = [1] + [2]

[4] R2001-1 USPS-T-7 at 51

[5] = - \$0.045 / \$0.291, where \$0.045 is the discount for 1.375 to 1.45 billion piece block and \$0.291 is the Capital One per-piece average First-Class Mail postage

[6] = [4] * [5]

[7] = [1] * [6]

[8] = [2] * [6]

[9] = [7] + [8]

[10] = [1] + [7]

[11] = [2] + [8]

[12] = [10] + [11]

Exhibit 7: SLS Consulting Projection of Capital One After-Rates First-Class Mail Volume - Method 2

FY 2003 Capital One Before-Rates Projection

First-Class Mail Solicitation Volume	768,000,000	[1]
First-Class Mail Customer Mail Volume	640,000,000	[2]
Total First-Class Mail	1,408,000,000	[3]

SLS After-Rates Projection Using USPS Price Elasticities - Method 2

Price Elasticity - Standard Mail	-0.388	[4]
Marginal Price Discount from NSA (Percent)	-17.2%	[5]
First-Class Mail Solicitation Volume Increase (Percent)	6.7%	[6]
First-Class Mail Solicitation Volume Increase (Pieces)	51,200,000	[7]
New Account Yield from Solicitations (Percent)	0.6%	[8]
New Account Yield from Solicitation Increase (Pieces)	307,200	[9]
Annual Pieces of Customer Mail Per Account	12.5	[10]
Portion of Year Average New Accounts are Active	50%	[11]
First-Class Mail Customer Mail Volume Increase (Pieces)	1,920,000	[12]
Total First-Class Mail Volume Increase (Pieces)	53,120,000	[13]
After-Rates First-Class Mail Solicitation Volume (Pieces)	819,200,000	[14]
After-Rates First-Class Mail Customer Mail Volume (Pieces)	641,920,000	[15]
Total After-Rates First-Class Mail Volume (Pieces)	1,461,120,000	[16]

[1] Capital One testimony

[2] Capital One testimony

[3] = [1] + [2]

[4] R2001-1 USPS-T-7 at 99

[5] = - \$0.050 / \$0.291, where \$0.050 is the discount for 1.45 to 1.525 billion piece block and \$0.291 is the Capital One per-piece average First-Class Mail postage

[6] = [4] * [5]

[7] = [1] * [6]

[8] Industry average solicitation response rate in 2001 from BAIGlobal

[9] = [7] * [8]

[10] Assumption

[11] Assumption

[12] = [9] * [10] * [11]

[13] = [7] + [12]

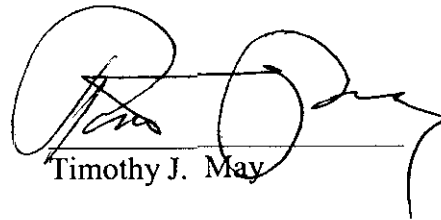
[14] = [1] + [7]

[15] = [2] + [12]

[16] = [14] + [15]

CERTIFICATE OF SERVICE

I hereby certify that I have this date served six (6) copies of the foregoing document upon the United States Postal Service by hand in accordance with Section 12 of the Rules of Practice.



Timothy J. May

Dated: September 19, 2002